NOVEMBER 23, 2022

TAPASYA INVESTMENT FUND I

GLOBAL INVESTMENT REVIEW - II

INTRODUCTION

Welcome to the **2nd edition** of the "**Global Investment Review**".

As mentioned in the previous letter, the intent of this document is to detail the thesis of the companies the fund has made investments in. Besides articulating the thesis of the investment, it would also help to look back at the assumptions made to understand which ones were true and the ones that did not work out. It would help me become a better investor and help overall returns for the fund. Its a practice I have been following before starting this fund.

In the first edition I featured Alphabet (Google) and Uber. I had called them spawners as both of them have shown the ability to open multiple large streams of revenue. I had also chosen those companies owing to their general popularity i.e. well known companies.

In this edition I would focus on our investments in **Europe**. We have 3 companies listed in Europe of which I will dive deeper into 2 companies, the 3rd though listed in Europe (Amsterdam stock exchange) is actually a South African company which I will review with you all in the next edition.

Lastly, as we come closer to the end of the year, I wanted to take a moment to thank you all for showing confidence in me. Wish you and your families a very thanksgiving and a happy new year!!

I would highly encourage all of you to ask me any questions you may have or challenge the theses. Feel free to do so via email or call me.

INVESTMENTS REVIEWED

In this document we will review 2 investments, **UMG** - Universal Music Group (UMG) which is listed on the Amsterdam Stock Exchange and **ASOS** (ASC) which is listed on the London Stock Exchange.

Universal Music Group is the largest music company in the world. **ASOS** is an online fashion apparel retailer that serves the UK, Europe, US and some other markets.

As you see, these companies are not only different from what they do, but also my expectations of them. In regard to UMG, I expect it to be a long term steady compounder with lower downside risk. For ASOS, it's that part of the portfolio where I expect asymmetric returns i.e. higher returns while carrying higher risk.

WHAT IS RISK?

I define risk as "*permanent loss of capital*" different from volatility which is "*movement of stock price in either direction*".

Volatility along with leverage (debt) is risky. In our case since we don't use leverage, at least not as yet we don't carry that part of the risk into our portfolio. Volatility as such is a friend of the investor as should be treated as such. The experience during a highly volatile period may not be great, but if one can stomach the volatility, many great bargains can be found.

In my view, the industry (hedge funds, mutual funds , etc.) has compromised for lower returns in order to create a less volatile environment for its clients. Individuals prefer less volatility i.e. a less bumpier journey is preferred over a better destination — that's just human nature.

UNIVERSAL MUSIC GROUP (UMG)

UMG is the largest music company in the world, and dominates the music industry as part of the “Big Three” record labels, alongside Warner Music Group and Sony Music.

The company owns and operates businesses engaged in recorded music, music publishing, merchandising, and audiovisual content. The company is based in Hilversum, the Netherlands.

Why choose this industry/business

Music knows no borders, has survived generations, wars , etc. The medium of consumption of music has changed but humans’ need/want to listen to music has only grown over the years.

This industry has proven to be inflation resistant over time. Also, as different parts of the world get more prosperous over time, discretionary spend increases which includes spend into the music industry e.g. attending concerts, subscribing to platforms such as Spotify, Apple Music, YouTube Music , buying merchandise , etc.

Let's start with some financial history.

Income Statement | TIKR.com	1/1/19	12/31/19	12/31/20	12/31/21	LTM
Revenues	6,023.00	7,159.00	7,432.00	8,504.00	9,407.00
Total Revenues	**6,023.00**	**7,159.00**	**7,432.00**	**8,504.00**	**9,407.00**
% Change YoY		***18.9%***	***3.8%***	***14.4%***	
Cost of Goods Sold	(3,110.00)	(3,818.00)	(3,917.00)	(4,608.00)	(5,169.00)
Gross Profit	**2,913.00**	**3,341.00**	**3,515.00**	**3,896.00**	**4,238.00**
% Change YoY		***14.7%***	***5.2%***	***10.8%***	
% Gross Margins	***48.4%***	***46.7%***	***47.3%***	***45.8%***	***45.1%***

As you would see above; it UMG has had a steady revenue growth and continues to grow in 2022 which has been a challenging year for many companies. Its IPO was in Sept’2021.

It has a very **healthy gross margin rate of approx. 45%.** As you may have gathered from my previous letters, gross margin rate is a very important metric for me.

Typically I don't look at companies below 20% Gross margin rate (exception Costco). The reason for that, high gross margin rate suggests the companies ability to charge a premium for the value they are providing the customer. A low number suggests a very highly competitive market or little value being added. As an investor I am always on the lookout for monopolistic businesses.

Cash Flow Statement | TIKR.com	1/1/19	12/31/19	12/31/20	12/31/21	LTM
Free Cash Flow	**637.00**	**610.00**	**897.00**	**1,127.00**	**1,243.00**
% Change YoY		***(4.2%)***	***47.0%***	***25.6%***	
% Free Cash Flow Margins	***10.6%***	***8.5%***	***12.1%***	***13.3%***	***13.2%***

Free Cash Flow (FCF) is another metric that is very key to me. They have almost doubled their FCF in the past 4 years and I expect that to continue to grow at a steady pace.

Ratios | TIKR.com	1/1/19	12/31/19	12/31/20	12/31/21	LTM
Return Ratios:					
Return on Assets %		7.7%	7.7%	7.5%	7.9%
Return on Capital %	20.1%	25.0%	20.6%	23.6%	20.9%
Return On Equity %		32.6%	59.3%	48.5%	36.7%

Another of my preferred metrics is **Return on Capital**, with a preference of 20%+. Basically over the long term the return an investor gets is close to the Return on Capital.

A quote from Charlie Munger below

"Over the long term, it's hard for a stock to earn a much better return than the business which underlies it earns. If the business earns 6% on capital over 40 years and you hold it for that 40 years, you're not going to make much different from a 6% return even if you originally buy it at a huge discount. Conversely, if a business earns 18% on capital over 20 or 30 years, even if you pay an expensive looking price, you'll end up with a fine result. So the trick is getting into better businesses. And that involves all of these advantages of scale that you could consider momentum effects."

The investor of today does not profit from yesterday's growth. The question hence arises - How confident we are about its future AND did we overpay for this stock?

Let me answer the over-pay question, this could be a little subjective at times but will do my best to explain how I look at it.

Are we buying the stock at a good price?

I am sure you would have all heard about "**Margin of Safety**" and I use this term as well (don't expect anything original from me, I just learn from others).

"Margin of Safety" as Buffett has defined is buying the company at a lower price than its intrinsic value. The higher the discount OR lower the price relative to intrinsic value, the higher the margin of safety.

The question then arises is what is 'Intrinsic value' of the company. It was easier to describe this in the earlier days where companies had a lot of physical assets, with the advent of software this has gotten harder.

Intrinsic Value can be defined as the amount/$'s one should pay today for a company (or stock) is based on the future cashflows the company is going to produce from now to Judgment Day.

As I write this, I am sure I have lost some of you hence in the annual meeting I will talk more about this and you will get an opportunity to ask questions.

For now to simplify, I will tell you what I do. Below is one of the 2 techniques I use. This method is used for cash flow generating companies only. I calculate **Free Cash Flow Yield**, the calculation being FCF/Market-cap.

In the case of UMG at the time of writing, Free Cashflow was Euro 1,243MM divided by 38Bn which is its market cap. The FCF yield is 3.2%.

I then make a comparison to the Fed fund rate (typical environment and not the latest numbers) to see if this is equal or better. If this is better and I expect the business to continue to grow I would consider buying the company at a fair price.

How does UMG make money

UMG has 3 revenue streams, Recorded Music, Music Publishing and Merchandising/Other

Recorded Music-This by far is the largest segment of revenue representing approx. 77% of total revenues. This is dedicated towards discovering and developing recording artists, marketing, promoting, distributing and licensing the music they create.

This business is further split into Subscription/Streaming, downloads/digital, physical and license. Without boring you with too much details, each of these segments outside of physical (showing slow growth and expectedly so) are growing at double digit growth rates.

Music Publishing-This is the 2nd largest revenue stream contributing approx. 17% of total revenues. This is focussed towards acquiring and administering rights to musical compositions, and licensing them for use in multiple formats.

This is broken out into Performance, Synchronization, Digital, Mechanical and Other. This business is growing double digits with all the growth coming from Digital and Synchronization.

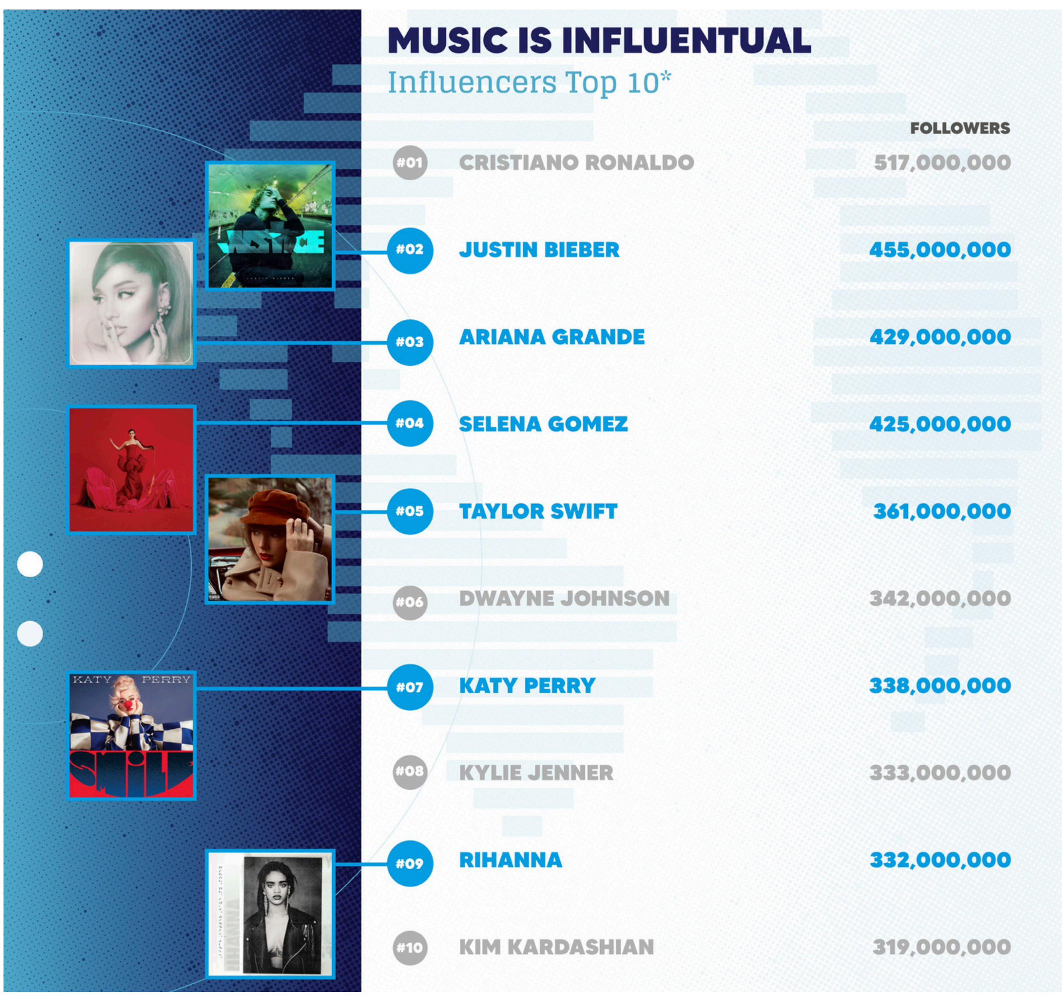
Merchandising/Other-This is the 3rd revenue segment of revenue representing approx. 6% of total. This grew over 100%+ in 2022 due to removal of Covid restrictions and return of concerts , etc.

What is their Revenue Driver?

In the case of UMG their key revenue driver is their ability to retain existing talent/artists and continue to find new talent and develop them. Coupled with that is their ability to create an ecosystem where the fans feel close to the artists and want to spend more over time.

Of course there are many other aspects to the business involved to make all this successful, but that's left to the capable hands of the management team while we focus here.

Artists: UMG has 6 (and 100% of music artists) of the top 10 social media influencers in the world. See list below. They maintain close relationships with the artists, work on long term career development, services such as marketing, distribution , etc.



Fans: As far as the fan base is concerned, accessibility to the fan base, premium oriented products for super fans , etc., are important which they prioritize. At the end, fans need to feel a direct connection with the artist.

To boil it all down to a few lines of why I believe this company can be a long term compounder

1) Proven track record of managing artists globally
2) Expansion in growth markets such as Japan, China, Korea and India
3) Growth in music consumption
4) Shared revenue model with companies like META, TikTok etc
5) Gaming, Fitness and Auto companies partnering with UMG
6) Network Effect - mixing artists from different regions e.g. Badshah and Latin singers
7) Music industry is inflation resistant

Risks that could undermine our thesis

1) Would streamers such as Spotify have direct contracts with artists e.g. Spotify with Joe Rogan.
2) Ability to continue to attract new talent and associated monetization
3) Bad Act by top artists and need to break ties leading to losses.

ASOS

ASOS Plc operates as an online fashion retailer in the United Kingdom, the United States and Europe. The company was founded in 2000 and is headquartered in London, the United Kingdom.

As mentioned in the introduction section of this document, I have asymmetric expectations from ASOS i.e. higher returns for potential higher risk. ASOS at this time represents about 3% of our total portfolio.

We own this stock on the London stock exchange, under the ticker ASC.L

I will briefly share the past historical information here, but more importantly this is to look at what the future expectations from this company are, what the catalysts are to unlock this value and how likely do we think this could occur.

Financial history

Income Statement | TIKR.com	8/31/16	8/31/17	8/31/18	8/31/19	8/31/20	8/31/21	8/31/22	LTM
Revenues	1,444.90	1,923.60	2,417.30	2,733.50	3,263.50	3,910.50	3,936.50	3,936.50
Total Revenues	**1,444.90**	**1,923.60**	**2,417.30**	**2,733.50**	**3,263.50**	**3,910.50**	**3,936.50**	**3,936.50**
% Change YoY	***26.4%***	***33.1%***	***25.7%***	***13.1%***	***19.4%***	***19.8%***	***0.7%***	
Cost of Goods Sold	(722.70)	(965.30)	(1,180.20)	(1,399.20)	(1,716.10)	(2,134.10)	(2,219.00)	(2,219.00)
Gross Profit	**722.20**	**958.30**	**1,237.10**	**1,334.30**	**1,547.40**	**1,776.40**	**1,717.50**	**1,717.50**
% Change YoY	***26.0%***	***32.7%***	***29.1%***	***7.9%***	***16.0%***	***14.8%***	***(3.3%)***	
% Gross Margins	***50.0%***	***49.8%***	***51.2%***	***48.8%***	***47.4%***	***45.4%***	***43.6%***	***43.6%***

As you see here, the revenues have grown at a reasonable clip from GBP 1.4Bn in 2016 to GBP 3.9Bn in 2022. The gross margin rate though having declined over the years continues to be mid-40s which is quite healthy for apparel; though there is room for expansion.

The company has had a declining return on capital employed, and has been severely punished with a stock price in single digits and only about 0.2x is total sales. Hence quite cheap compared to the revenue it generates.

The question is whether this company can stage a turn-around. This would constitute higher revenue growth rates above 15% each year along with improved profitability and cashflows.

Over the medium term the company is looking at growing revenues between 15%-20% CAGR at a EBIT of 4%+ and Capex of GBP 200M-250M. This if executed would certainly be a significant value unlock.

That said recent history does not exude a lot of confidence. Let us look at the changes that have been made to project some likelihood of this happening

1) **Management Changes**: The company has made many changes to its leadership including a new CEO. In general, if I own a company stock one of my reasons to sell is significant changes to initial thesis/fundamentals and leadership changes — especially if leadership is exclusively external. In this case they have promoted their COO to the CEO position. In most turnarounds internal employee tends to have a better chance of success than external, though the later has happened as well

2) **Increased focus on Specific Markets**: Focus on key markets such as the UK, US and Europe should drive revenues. Partnership with Nordstrom for in-store sales (currently not in all stores) should drive awareness and increases revenues overtime in the US market

3) **Shorter Buying Cycle:** In fashion apparel a key factor for success is a curated assortment that is constantly refreshed based on seasons and fashion trends. This incentivizes repeat trips from the customer. The company is making changes to their buying processes to enhance merchandise refresh.

4) **Improved profitability**: the CEO has committed to gross margin expansion and a lighter cost profile. Given their higher SG&A profile; this should be an immediate area to address. It is unfortunate that the business was allowed to get here to begin with. In any-case, I think amongst the things a CEO/CFO can control SG&A is probably the one I would have the most confidence about. Some of the changes here could take longer e.g. warehouse costs that have been driven higher due to labor cost increases which

can be reduced only through automation. While there are others such as Distribution costs that there may be more short term solutions.

Hence to summarize, I do expect the company to be a multi-bagger over the next 4-5 years. I do expect the company to start showing progress in profitability over the short term to feel confident about the management's ability to execute. My horizon for seeing meaningful changes in profitability is about 6-8 quarters.

This company has the ability to continue to drive its revenues across all the 3 markets and can be a long term compounder should it be able to address some of the near term challenges.

This one will be a very interesting story to watch as it unfolds.

CONCLUSION

This document is an attempt to summarize my thesis around each of the investments made. All investments are made with a multi-year horizon. I prefer to give each company at least 2 years from purchase date approx. to understand whether the thesis is being realized or not. Markets are volatile and investment decisions many times are emotion driven. That is the reason one needs to give time after an investment is made.

I would welcome any feedback you may have on this document and as always feel free to reach out to me by email or phone if you have any questions.

We are in this journey together, our biggest advantage is going to be our collective focus on the long term along with my skills on capital allocation.

If you have managed to read this document in its entirety itself is one measure of success for me, as unless I receive feedback I will assume it was a reasonably good read.

In my next Global Investment Review, I will focus on our investments in China.

APPENDIX

In regard to the investment thesis document, I want to mention some references that I have used for ideas on writing this document.

Firstly, Nick Sleep and Qais Zakaria (Nomad Investment Partnership), used to provide such documentation to their investors. You would see a common thread across my investment philosophy and how I manage the fund, similar to Nomad's which closed in early 2014.

Others that I have referenced are based on what I have read over the years which includes Warren Buffet's Annual Shareholder Letters, Nick's thesis on Costco and also Guy Spier's communication to his investors.

All of this information is in the public domain.

Just a quick note on my view on macro conditions and a repeat from my last letter.

Inflation & Macro Conditions

One of the things to note, especially in today's context, is that I don't pay too much attention to macro factors, they are very important and do play a large role in impacting the stock prices and results of companies. What I do expect, is for the companies invested in, they show far more resilience than the rest of the market. Would like to quote Peter Lynch a legendary investor at Fidelity managing a fund called as Magellan.

"Nobody can predict interest rates, the future direction of the economy or the stock market. Dismiss all such forecasts and concentrate on what actually happening in the companies you have invested in" — Peter Lynch